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INTERNATIONAL COUNTERTRADE

Draft chapters of legal guide on drawing up contracts in international countertrade transactions*

Report of the Secretary-General

Addendum

XIII. FAILURE TO COMPLETE COUNTERTRADE TRANSACTION**

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* The text contained herein is a first draft prepared by the Secretariat for consideration by the Working Group on International Payments as part of the preparatory work on the draft legal guide on drawing up contracts in international countertrade transactions and should not be regarded as stating the views of the Working Group.

** A different title is used in the present addendum for draft chapter XIII than was used in the proposed structure of the legal guide (A/CN.9/WG.IV/WP.51, paragraph 9) and in some other draft chapters.

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A. General remarks

1. This chapter discusses remedies for non-fulfilment of the countertrade commitment (sections B and C). It also discusses circumstances in which a party would be exonerated from liability for a failure to fulfil the countertrade commitment (section D). A further issue discussed in the present chapter is the effect of a failure to fulfil the countertrade commitment or of the failure to perform a supply contract in one direction on the obligations of the parties to conclude or perform supply contracts in the other direction (section E). Not discussed are remedies for non-performance of a supply contract concluded pursuant to the countertrade agreement, since such remedies are of a type available under contract law generally and therefore do not raise issues specific to countertrade.

2. Failure by a party to fulfil its obligations under the countertrade transaction could have serious repercussions for the other party. The repercussions may be, for example, that a prospective supplier will not earn convertible funds planned to be used for purchase of other goods, that a prospective supplier will be hampered in carrying out its plan to introduce countertrade goods into new markets, or that a prospective purchaser will not receive goods to be resold in order to pay for goods shipped in the other direction.

3. It is advisable that the countertrade agreement stipulate the remedies for a failure to fulfil the countertrade commitment. National legal systems generally do not contain rules specifically tailored to countertrade, and general rules applicable to contractual obligations may not provide satisfactory answers when problems occur in fulfilling the countertrade commitment. The remedies that the parties might wish to address in the countertrade agreement include release from the countertrade commitment and liquidated damages or a penalty (see paragraphs 5 to 13, below). It is also advisable that the countertrade agreement define the circumstances in which a party would be exonerated from liability for a failure to fulfil the countertrade commitment (see paragraphs 14 to 37, below).

4. The remedies for non-fulfilment of the countertrade commitment that the parties have decided to include in a countertrade agreement may not be appropriate in every circumstance. Therefore, while a party has the right to insist upon the remedies set forth in the countertrade agreement, the parties may find it desirable to negotiate in the light of the available remedies before resorting to the procedures available to enforce them (see discussion on negotiation in chapter XV, "Settlement of disputes", paragraphs to).

B. Release from part or all of countertrade commitment

5. There are different circumstances in which a party may be released from its obligations under the countertrade commitment. Such a release can result from a payment of liquidated damages or a penalty stipulated in the countertrade agreement for non-fulfilment of the countertrade commitment (see paragraph 10, below, as well as chapter XI, "Liquidated damages and penalty clauses", paragraph). A release of a party may also result when an action or omission by the other party causes the failure to fulfil the commitment (see paragraph 6, below). A further ground for a release may be the occurrence of circumstances that the applicable law or the countertrade agreement defines as exempting impediments (see paragraphs 14 to 37, below). Yet another situation in which a party may be released is when the supply contract in the other direction is terminated (see paragraph 48, below). A party may be released from all of the unfulfilled countertrade commitment or from only a portion thereof. If the circumstances that give rise to the release affect only a portion of the unfulfilled countertrade commitment, the remaining portion of the countertrade commitment remains in effect.

6. The parties may wish to agree that, if the party committed to supply breaches its obligation to make available a portion or all of the goods in accordance with the terms of the countertrade agreement, the party committed to purchase is released from an equivalent portion or all of the countertrade commitment. Similarly, the parties may wish to agree that, if the party committed to purchase breaches its obligation to purchase a portion or all of the goods made available in accordance with the terms of the countertrade agreement, the party committed to supply is released from an equivalent portion or all of the countertrade commitment. When the parties so agree, they may wish to establish a notice requirement. Such a requirement might specify that the aggrieved party has to deliver a notice to the party in breach specifying the breach and informing the party in breach that the aggrieved party would be released from its obligations under the countertrade commitment to the extent that the breach was not remedied within a period of time specified in the notice or in the countertrade agreement. The period of time should be of a sufficient length to allow the remedying of the breach. The parties may wish to provide that the period of time commences to run from the date of the delivery of the notice. The parties may wish to consider whether it would be desirable to provide that, for the release to take effect, a second written notice would have to be delivered by the party claiming release.

7. Sometimes the countertrade agreement sets subperiods within the fulfilment period in which specified portions of the countertrade commitment must be fulfilled (for a discussion of such subperiods, see chapter VII, "Fulfilment of countertrade commitment", paragraphs 27 to 29). Such schemes often provide that a committed party that fails to fulfil the commitment allocated to a given subperiod may carry over a portion of the unfulfilled commitment to the following subperiod and that the party in breach must pay liquidated damages or a penalty on the unfulfilled portion that is not carried over. In such cases it may be provided that the party in breach is to be given an additional period of time, after the expiry of the subperiod, to remedy the breach (see the preceding paragraph).

8. It should be noted that some legal systems contain special requirements for the termination of a contract as a result of a breach. For

example, it may be required that additional time be granted to remedy the breach, that notice of intent to terminate be given, or that judicial consent be given. Were a release from a countertrade commitment to be interpreted as falling under those rules, such requirements might be applicable.

9. The countertrade agreement may provide that, if a release results from circumstances not attributable to either party (e.g., an exempting impediment), each party is to bear its own expenses and losses.

C. Monetary compensation

10. The countertrade agreement may provide that a breach by a party of the countertrade commitment entitles the aggrieved party to receive from the party in breach an agreed sum as liquidated damages or a penalty (liquidated damages and penalty clauses are discussed in chapter XI). It is desirable that the countertrade agreement specify whether a party paying liquidated damages or a penalty is released from the obligations under the countertrade commitment (for a discussion of the effect of payment of liquidated damages or a penalty, see chapter XI, paragraphs to).

11. Liquidated damages and penalties should be distinguished from the obligation found in legal systems generally to pay damages as compensation for loss suffered due to a breach of a contractual obligation. Liquidated damages or a penalty involve an amount agreed upon at the time the contractual obligation is entered into and are payable by a party who failed to perform the obligation without proof of loss by the aggrieved party (chapter XI, paragraph). By contrast, damages are assessed after the failure to perform a contractual obligation so as to compensate for the losses proved to have been suffered by the aggrieved party.

12. It might be possible for the party who suffered loss as a result of a failure to fulfil a countertrade commitment to claim, on the basis of legal rules generally applicable to a breach of a contractual obligation, damages from the party who failed to fulfil the commitment. The problem of liability for failure to fulfil a countertrade commitment raises the question of pre-contractual liability. The answer to this question is often not clear in legal systems, the approaches to the question differ under various legal systems, and the law of pre-contractual liability is undeveloped in some countries. A further source of uncertainty is the basis on which the extent of the damages would be calculated. If the important terms of the future supply contract (in particular type, quality and price of goods) are not sufficiently defined in the countertrade agreement, there would be an insufficient basis on which to calculate damages resulting from a failure to conclude that contract.

13. It is therefore advisable that the parties not leave the question of damages for non-fulfilment of the countertrade commitment to the applicable law. Instead, it is recommended that the parties include in the countertrade agreement a clause on liquidated damages or a penalty (see chapter XI, "Liquidated damages and penalties").

D. Exempting impediments

14. During the course of the period for fulfilment of the countertrade commitment, events may occur that impede a committed party to conclude an envisaged supply contract. An impediment may be of a legal nature, such as a change of regulations in the purchaser's or the supplier's country prohibiting the import or export of certain types of goods. An impediment may also be of a physical nature, such as a natural disaster preventing the production, transport or taking delivery of countertrade goods. Such impediments may prevent fulfilment of the countertrade commitment permanently or only temporarily. The party who fails to fulfil its countertrade commitment due to an impediment may, subject to the applicable law and to the provisions of the countertrade agreement, be granted additional time to fulfil the commitment or be released altogether from the countertrade commitment, and be exonerated from liability to pay damages. Impediments that give rise to such an exemption are referred to in the Legal Guide as "exempting impediments".

15. Many legal systems contain rules concerning exempting impediments. However, those rules may lead to results that are incompatible with the circumstances and needs of international countertrade transactions or do not allocate the risk of occurrence of exempting impediments as desired by the parties. Therefore, the parties may wish to include in their countertrade agreement an exemption clause defining exempting impediments and specifying the legal consequences of those impediments. It is advisable for the parties to select terminology that is, in the light of the applicable law, consistent with their intentions (see chapter IV, "General remarks on drafting", paragraph 6).

16. In the negotiation of the clause in the countertrade agreement on exempting impediments, it is in the interest of each party to have included in the clause the types of exempting impediments that could affect the ability of that party to take the actions required to fulfil the countertrade commitment. For example, the party committed to purchase would be interested in covering impediments such as import restrictions and physical impediments to the taking of delivery or the use of the goods. The party committed to supply goods would be interested in covering impediments such as restrictions on goods permitted to be exported in countertrade transactions and other export restrictions and certain impediments affecting the ability to produce the goods. It should be noted that, under the generally accepted principle of freedom of contract, the parties have latitude to agree on which of the parties is to bear the risk that a particular type of event impeding performance may occur. Accordingly, they would be free to exclude from the list of exempting impediments events that would be treated as exempting impediments by the applicable law and to include other events that would not be so treated by the applicable law.

17. The treatment in various legal systems of the subject of exemption differs with respect to the conceptual underpinnings of the subject and the terminology used. In relation to exemptions in the context of sales contracts, those differences have been bridged by the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980), article 79. 1/ The approach adopted in that Convention has been designed to take into account the particular circumstances and needs of international trade. The parties may find that approach to be a useful guide in formulating an exemption clause in a countertrade agreement. The discussion in this

chapter of the legal consequences of exempting impediments and the definition of exempting impediments (sections 1 and 2, below, respectively) is based upon the approach taken in the Convention.

1. Legal consequences of exempting impediments

18. The parties may wish to provide that, when fulfilment of the countertrade commitment is prevented by exempting impediments not exceeding a specified duration (e.g., 6 months), the fulfilment period would be extended for a period of time corresponding to the duration of the impediment. The purpose of such a provision would be to ensure that exempting impediments of a limited duration would not release the parties from the countertrade commitment. The parties may wish to stipulate in the countertrade agreement that, if an exempting impediment invoked by a party lasts longer than a specified duration, the other party may claim release from the countertrade commitment, or it may be agreed that either party may do so. The parties may wish to include in such a stipulation the obligation to engage in negotiations aimed at modifying the countertrade agreement in order to preserve the countertrade commitment.

19. As discussed in chapter XI, "Liquidated damages and penalty clauses", paragraph , in order to eliminate any uncertainty, the parties may wish to provide expressly that a party failing to fulfil the countertrade commitment due to an exempting impediment is exempt from the payment of liquidated damages or penalties, or of any damages that would otherwise be due under the applicable law.

2. Defining exempting impediments

20. The parties may wish to include in the countertrade agreement a definition of exempting impediments. The parties may wish to adopt one of the following approaches: (a) providing only a general definition of exempting impediments; (b) combining a general definition with a list of exempting impediments; (c) providing only an exhaustive list of exempting impediments.

(a) General definition

21. A general definition of exempting impediments would enable the parties to ensure that all events having the characteristics set forth in the definition would be considered as exempting impediments. The purpose of a general definition is also to exclude events that do not meet those characteristics. This approach would avoid the need to compile a list of exempting impediments, and would avoid the risk of omitting from the list events that the parties would have considered as exempting impediments. On the other hand, it could be difficult in some cases to determine whether or not a particular event was covered by the general definition.

22. The parties may wish to include in the definition the stipulation that fulfilment of the countertrade commitment must be prevented by a physical or legal impediment (see paragraph 14, above), and not, for instance, only made inconvenient or more expensive. It should be noted, however, that a change in circumstances may occur that makes fulfilment of the countertrade commitment, while still physically possible, excessively costly, beyond what a party could be expected to have foreseen and to have to bear. Such an extreme change in circumstances may be regarded under the applicable law as an exempting

impediment. In addition, the parties may wish to provide that the impediment must be beyond the control of the party failing to fulfil a countertrade commitment and that that party could not reasonably be expected to have taken the impediment into account at the time the countertrade agreement was entered into or to have avoided or overcome the impediment or its consequences.

23. Contractual clauses on exempting impediments sometimes merely list a number of exempting impediments and indicate that other similar events would also be considered as exempting impediments. In such a clause, the listed events serve as an indication whether an event not included in the list should be regarded as an exempting impediment. Nevertheless, inclusion of a general definition in the clause is likely to reduce uncertainty whether an event not included in the list should be regarded as an exempting impediment.

(b) General definition with list of exempting impediments

24. A general definition of exempting impediments might be followed by either an illustrative or exhaustive list of events that are to be regarded as exempting impediments. This approach would combine the flexibility afforded by a general definition with the certainty arising from the specification of exempting impediments.

(i) General definition with illustrative list

25. Examples of exempting impediments to be included in an illustrative list may be chosen so as to clarify the scope of the general definition. Such an approach could give guidance as to the intended scope of the general definition and ensure that the events set forth in the list would be treated as exempting impediments if they meet the criteria set forth in the general definition.

(ii) General definition with exhaustive list

26. A general definition of exempting impediments might be followed by an exhaustive list of events that are to be regarded as exempting impediments if they meet the criteria contained in the general definition. An exhaustive list may be inadvisable unless the parties are certain that they can foresee and list all events which they would wish to be regarded as exempting impediments.

(iii) General definition with list of exempting impediments whether or not they come within definition

27. A general definition of exempting impediments might be followed by a list of events that are to be regarded as exempting impediments whether or not they come within the general definition. This approach may be useful where parties choose a narrow general definition of exempting impediments, but wish certain events that do not fall within the scope of that definition to be regarded as exempting impediments. Since those events would constitute exempting impediments independently of the general definition, the remarks in paragraph 28, below, concerning safeguards that may be adopted when providing a list of exempting impediments without a general definition, are also applicable here.

(c) Exhaustive list of exempting impediments without general definition

28. It is possible for an exemption clause simply to provide an exhaustive list of events that are to be considered exempting impediments, without a general definition. This approach has the disadvantage of not providing general criteria in a definition that the listed events must meet in order to be regarded as exempting impediments. Since such general criteria are not provided, it is advisable for the parties to describe the exempting impediments on the list as precisely as possible. The advantage of such precision is certainty as to the allocation of risk between the parties.

(d) Possible exempting impediments

29. If the parties set forth in the exemption clause a list of events that are to be considered exempting impediments, with or without a general definition, they may wish to consider whether it is desirable to include events such as fire, explosion, and trade embargo. Furthermore, the parties may wish to narrow the scope of the events listed below.

30. Natural disasters. Natural disasters such as storms, cyclones, floods or sandstorms may be normal conditions at a particular time of the year at the relevant location. In such cases, the countertrade agreement contract might preclude a party from invoking them as exempting impediments if they were foreseeable and if effective counter-measures could have been taken (see paragraph 23, above).

31. War (whether declared or not), other military activity or civil unrest. It may be difficult to determine when a war, other military activity or civil unrest can be considered as preventing performance of an obligation. For instance, hostilities may be taking place in the country of a party, but, if commercial activities by that party continue, the hostilities may not actually prevent a party from fulfilling the countertrade commitment. If the countertrade agreement does not contain a general definition of exempting impediments, it may be desirable to specify clearly when a war, other military activity or civil unrest is considered to prevent fulfilment of a countertrade commitment.

32. Strikes, boycotts, go-slows and occupation of factories or premises by workers. The parties may wish to consider whether and the extent to which these events are to be considered as exempting impediments. On the one hand, such events could in a real sense prevent a party from fulfilling its commitment. On the other hand, the parties might consider that it would not be advisable for a party to be exempted from the consequences of a failure to fulfil a commitment when the failure resulted from the conduct of its own employees. In addition, it may be difficult to determine whether or not strikes by employees and other labour disputes are avoidable by a party, and what measures the party might reasonably be expected to take to avoid or to end the strike or dispute (e.g., meeting the strikers' demands). In that connection, the parties may wish to provide that only strikes that do not arise from labour relations between the party and its employees (e.g., sympathy strikes) are to be regarded as exempting impediments.

33. Shortages of raw materials needed in production. The parties may wish to consider whether this is to be considered as an exempting impediment. They

might, for example, consider that it is the obligation of a party to procure raw materials in time and, therefore, preclude a claim for an exemption if the raw materials had not been procured. In some cases, the party may fail to have the materials available on time due to a delay by its supplier. For those cases, however, it would be advisable for the party to ensure that the contract with its supplier of the materials provides for damages for failure to supply the materials.

(e) Exclusion of impediments

34. Whichever approach to defining exempting impediments is adopted, the parties may wish further to clarify the scope of an exemption clause by expressly excluding some events. For example, the parties may wish to exclude from exempting impediments events that occur after a breach of the countertrade commitment by a party and that, but for the breach, would not have prevented fulfilment of the commitment by that party.

35. The parties may wish to consider whether certain acts of a State or of State organs are to be regarded as exempting impediments. A party may be required to secure a licence or other official approval for the conclusion of a supply contract. The countertrade agreement might provide that if the licence or approval is refused by a State organ, or if it is granted but later withdrawn, the party that was required to obtain the licence or approval cannot rely on the refusal or withdrawal as an exempting impediment. The parties might consider that it is equitable for the consequences of the absence of the licence or approval to be borne by the party that had the duty to obtain it, since that party undertook the countertrade commitment knowing of the necessity to obtain the licence or approval and the possibility of its being refused. Moreover, it might be difficult for the other party to determine whether the measures taken to obtain the licence or approval were reasonable (see paragraph 23, above).

3. Notification of impediments

36. It is desirable for the countertrade agreement to obligate a party invoking an exempting impediment to give written notice of the impediment to the other party without undue delay after the party invoking the impediment learned or could reasonably have been expected to learn of the occurrence of the impediment. This notification could facilitate the taking of measures by the other party to mitigate any loss. It may be required that the notice specify details of the impediment, together with evidence that the fulfilment of a countertrade commitment by the party is prevented or is likely to be prevented, and, if possible, the anticipated duration of the impediment. The party invoking the exempting impediment might also be required to continue to keep the other party informed of all circumstances that may be relevant for an ongoing appraisal of the impediment and its effects, and to notify the other party of the cessation of the impediment. It may be provided that a party who fails to notify the other party in time of the exempting impediment loses the right to invoke the exempting impediment. Alternatively, it may be provided that a party who fails to give the required notification in time remains entitled to invoke the clause, but is liable to compensate the other party for losses resulting from the failure. The countertrade agreement might also provide that an exempting impediment, or certain types of exempting impediments, must be verified, for example, by a public authority, notary public, a consulate or chamber of commerce in the country where the impediment occurred.

37. Further, the parties may wish to provide that, upon notification of an exempting impediment, they are to meet and consider what measures to take in order to prevent or limit the effects of the impediment, and to prevent or mitigate any loss that may be caused by it. These measures might include re-negotiation of the countertrade agreement (see paragraph 18, above).

E. Effect on countertrade transaction of failure to conclude or perform supply contract

38. A feature of a countertrade transaction is the link between the supplies of goods in the two directions in that the conclusion of the contract for the supply of goods in one direction is conditioned upon the conclusion of the contract for the supply of goods in the other direction (see chapter II, "Scope and terminology of legal guide", paragraph 1). In view of this link, a question may arise whether a failure to conclude a supply contract or a failure to perform an existing supply contract in one direction should have an effect on the obligation to conclude a supply contract or to perform an existing supply contract in the other direction. For example, if in a counter-purchase transaction the export contract is terminated, the question may arise whether the exporter is entitled to be released from its obligations to purchase goods pursuant to the countertrade commitment. Similarly, if in a counter-purchase transaction the exporter fails to take the action necessary to fulfil the countertrade commitment, the question may arise whether the counter-exporter is entitled to suspend payment under the export contract or to terminate the export contract.

39. Many national legal systems contain general rules of contract law that provide an answer regarding interdependence of obligations incorporated in one contract. The general principle usually expressed in those rules is that non-performance by one party of its contractual obligations under a contract authorizes the other party not to perform its obligations under that contract, and that in some circumstances the other party is authorized to terminate the contract. Usually non-performance of one's own contract obligations and termination of the contract is not authorized when the failure of the other party is not sufficiently serious. National legal systems normally do not provide a specific answer to the question of interdependence of obligations involved in various types of countertrade transactions and also do not clarify to what extent the above-mentioned general principles of contract law can be applied in a countertrade transaction.

40. It is often suggested that the particular contract structure of the countertrade transaction is an important element in determining the interdependence of obligations in countertrade transactions. If the obligations in a countertrade transaction are merged into a single contract, it is generally considered that the mutual obligations are likely to be considered as interdependent (the single-contract approach is discussed in chapter III, "Contracting approach", paragraphs 2 to 9). If, however, separate contracts are used for the shipments in the two directions, it has been suggested that in many legal systems the two sets of obligations would likely be regarded as independent, except to the extent specific contract provisions establish interdependence (the separate-contracts approach is discussed in chapter III, "Contracting approach", paragraphs 10 to 21) [note to the Working Group: paragraphs 9, and 16 to 18, of chapter III would have to be aligned with the present text]. On the other hand, it has been suggested

that despite the use of separate contracts, the obligations in a countertrade transaction could be regarded as interdependent on the ground that those obligations embodied in separate contracts are commercially interrelated and thus form part of a single transaction.

41. Because there is a dearth of judicial and arbitral decisions on the question of interdependence of obligations in countertrade transactions, generalizations cannot be made. The extent of interdependence will depend on the circumstances and contractual provisions of each case. In order to avoid disagreements as to whether a party is entitled to withhold fulfilment of its obligation as regards the supply of goods in one direction on the ground that the other party has failed to fulfil its obligation as regards the supply of goods in the other direction, the parties might wish to include in the countertrade agreement specific provisions indicating the extent of interdependence of obligations. Provisions determining the extent of interdependence of obligations may be included to address in particular the following problems in the fulfilment of the countertrade transaction: (i) failure to conclude a supply contract as stipulated in the countertrade agreement, (ii) termination of a supply contract, (iii) failure to meet a payment obligation under a supply contract, and (iv) failure to deliver goods under a supply contract.

1. Failure to conclude supply contract

42. In transactions in which the parties first conclude the supply contract in one direction (export contract) and leave the conclusion of the supply contract in the other direction (counter-export contract) to a later time (see chapter III, "Contracting approach", paragraphs 12 to 18), the parties may wish to consider whether the failure of the exporter (counter-importer) to take an action necessary to fulfil the countertrade commitment should entitle the importer to suspend payment for the imported goods, or even to terminate the export contract. Such interdependence may be viewed favourably by an importer whose ability to meet payment obligations under the export contract depends on the proceeds of the counter-export contract to be concluded pursuant to the countertrade agreement.

43. In considering whether to establish such interdependence between the countertrade commitment and the export contract, the parties may wish to take into account the possible amount of the counter-exporter's loss arising from the failure to fulfil the countertrade commitment and the possible amount of the exporter's loss arising from the suspension of payment under the export contract or from the termination of the export contract. It may not be desirable to allow a problem in the fulfilment of the countertrade commitment to disrupt the performance of the export contract. The parties may make such an assessment when the price to be paid under the export contract or the possible loss from the termination of the export contract is considerably higher than the possible loss from the failure by the counter-importer to fulfil the countertrade commitment. Furthermore, interdependence may not be desirable because of the possibility that the parties would disagree as to responsibility for the failure to conclude a supply contract. The possibility of suspension of payment under the export contract until the resolution of such a disagreement might introduce an unacceptable degree of uncertainty in the transaction. Moreover, the risk of non-payment under the export contract because of a problem in the fulfilment of the countertrade commitment may make it difficult for the exporter to find a financial institution to finance the

export or to insure a non-payment risk. A reason for the financial institution's reluctance may be the fact that a possible difficulty the exporter may face in fulfilling the countertrade commitment is a circumstance extraneous to the export contract and difficult for the financial institution to assess. For reasons discussed in paragraphs 39 to 41, above, the parties may wish to express in the countertrade agreement such independence of the export contract from the fulfilment of the countertrade commitment.

44. However, in order to protect the interests of the counter-exporter, it may be appropriate to provide in the countertrade agreement for compensation of the loss expected to be suffered as a result of a failure to conclude the counter-export contract. The obligation to provide such compensation may be established by a liquidated damages or penalty clause in the countertrade agreement (see paragraphs 10 to 13, above, as well as chapter XI, "Liquidated damages and penalty clauses", and chapter XII, "Security for performance"). Furthermore, the countertrade agreement may grant the counter-exporter the right to deduct from payments due under the export contract the amount of liquidated damages or a penalty due for the failure to fulfil the countertrade commitment (see chapter IX, "Payment", paragraphs 9 and 57, and chapter XI, "Liquidated damages and penalty clauses", paragraph).

45. In transactions in which a countertrade agreement is concluded before the conclusion of supply contracts in either direction (see chapter III, "Contracting approach", paragraph 19), the parties may not find it useful to entitle a party to suspend performance of, or to terminate, a concluded supply contract in one direction in response to a failure by the other party to take an action necessary to conclude a supply contract in the other direction. In such transactions, the countertrade agreement often provides for the conclusion of a series of supply contracts in both of the two directions. Making the performance of contracts that have already been concluded in one direction dependent on the conclusion of contracts in the other direction may disrupt rather than stimulate orderly implementation of such a countertrade transaction. Accordingly, for reasons discussed above in paragraphs 39 to 41, the parties may wish to indicate expressly in the countertrade agreement that the obligations under the supply contracts in one direction are independent from the fulfilment of the countertrade commitment in the other direction.

46. In some cases the countertrade agreement may provide that a failure by a party to conclude supply contracts in one direction entitles the other party to suspend conclusion of contracts, or to suspend shipment of goods, in the other direction. Such an approach may be used in particular when it is agreed that during the course of the countertrade transaction the value of the goods supplied in one direction should not exceed the value of the goods supplied in the other direction by more than an agreed amount or percentage. This approach may be agreed upon when the parties stipulate that their mutual payment claims arising from the supply contracts in the two directions are to be set off and that the imbalance in the value of goods shipped in the two directions should not exceed an agreed limit (see chapter IX, "Payment", paragraphs 35 to 52, in particular paragraph 49). In order to monitor the level of trade between the parties and to specify the situations in which a party is entitled to suspend conclusion of contracts or supplies of goods, the parties might agree that their mutual supplies of goods are to be recorded in an "evidence account" (see chapter VII, "Fulfilment of countertrade commitment", paragraphs 38 to 44).

47. When the countertrade agreement provides that the countertrade commitment in one direction should not affect obligations under existing supply contracts in the other direction, the countertrade agreement may nevertheless establish sanctions for the failure to fulfil the countertrade commitment. For example, in transactions in which countervailing claims for payment for the supply of goods in the two directions are to be set off, the countertrade agreement may provide that a party that receives more goods than it ships is to liquidate the imbalance either through cash payments or through the shipment of additional goods (see chapter IX, "Payment", paragraphs 49 to 51). When the goods supplied in the two directions are to be paid for independently, the countertrade agreement may contain a liquidated damages or penalty clause or provide for the issuance of a bank guarantee or stand-by letter of credit covering non-fulfilment of the countertrade commitment (see chapter XI, "Liquidated damages and penalty clauses", and chapter XII, "Security for performance").

2. Termination of supply contract

48. A supply contract may be terminated, for example, as a result of a breach of the contract by one party or as a result of an exempting impediment. For reasons discussed in paragraphs 39 to 41, above, the parties may wish to clarify in the countertrade agreement whether such a termination of a supply contract in one direction is to affect the obligations of the parties to conclude a future supply contract in the other direction or to perform an existing supply contract in the other direction. Various solutions can be considered:

(i) not to allow the termination of a supply contract in one direction to affect the countertrade commitment stipulating the conclusion of a supply contract in the other direction, or any obligations under an existing supply contract in the other direction;

(ii) to provide that termination of a supply contract in one direction is to release the parties from the countertrade commitment stipulating the conclusion of a supply contract in the other direction, but that, if a supply contract in the other direction has already been concluded, that supply contract is not to be affected;

(iii) to provide that termination of the supply contract in one direction is to result in the release from the countertrade commitment to conclude a supply contract in the other direction as well as in the termination of any existing supply contract in the other direction, unless specified actions for performance of the existing supply contract have already been taken (e.g., goods have been prepared for shipment or have been shipped).

49. The solution under (i) may be appropriate in transactions in which the countertrade agreement provides for the conclusion of a series of supply contracts in both directions. In counter-purchase and buy-back transactions, it may also be appropriate to provide that the termination of a given counter-export contract should not affect the export contract. In these cases it may be possible for the parties to conclude a substitute supply contract for a terminated supply contract (see paragraph 54, below). Because of this possibility, as well as the possibility of exercising remedies available under the terminated supply contract, the parties may not wish that the termination

of a given supply contract in one direction should affect the conclusion or performance of contracts in the other direction.

50. As to the possible effects of the termination of the export contract in a counter-purchase, buy-back or indirect offset transaction, the solution under (i) may be preferred by the importer (counter-exporter). An important objective of the importer for engaging in countertrade is often to find an outlet for its goods, and the need to find such an outlet would usually not be diminished by termination of the export contract. This solution may also be favoured by a third-party purchaser engaged by the exporter to fulfil the exporter's countertrade commitment; the third-party purchaser may be interested in the countertrade commitment remaining effective in order to be able to earn the fee agreed upon with the exporter or in order to recoup expenses incurred in anticipation of the purchase and resale of the countertrade goods (see chapter VIII, "Participation of third parties", paragraph 32). The exporter (counter-importer), on the other hand, is likely to favour solution (ii), in particular if the exporter does not expect a profit through the purchase and resale of the countertrade goods. In these types of transactions the exporter usually assumes a countertrade commitment in order to be able to export its own goods and would therefore not wish to remain subject to the countertrade commitment upon termination of the export contract, but at the same time would not wish to terminate existing counter-export contracts. In indirect offset transactions there is an additional reason for adopting the solution under (ii), namely, that the exporter (counter-importer) concludes counter-import contracts with third-party suppliers and it would be undesirable to terminate those contracts due to circumstances that do not concern those third parties.

51. The question may arise whether, despite the release from the countertrade commitment, pursuant to the solution in (ii), of the party originally committed to purchase, a third-party purchaser engaged by the exporter (counter-importer) would continue to be entitled to receive a fee from the exporter (counter-importer) for purchases made from the counter-exporter after the release. As discussed in chapter VIII, "Participation of third parties", paragraph 32, it is advisable that the parties provide an express answer to this question in the countertrade agreement.

52. The solution under (iii) might be adopted when the parties consider that the countertrade transaction cannot proceed if a supply contract in one direction is terminated. This might be the case, for example, when the parties agree to link their payment obligations so that the proceeds of the supply contract in one direction would be used to pay for the supply contract in the other direction (chapter IX, "Payment"), or when, as in a direct offset transaction, the goods supplied by one party are to be incorporated in the goods to be supplied in the other direction. The solution under (iii) would also be indicated in buy-back transactions in which the possibility of fulfilling the countertrade commitment is contingent upon the performance of the export contract.

53. When solution (ii) or (iii) is adopted, the parties may wish to clarify in the countertrade agreement that a party would be released from its obligations under the countertrade commitment or an existing counter-export contract on the basis of the termination of the export contract only if that party was not responsible for the termination of the export contract. The

countertrade agreement may further provide that when one of the parties is responsible for the termination of the export contract (e.g., because of delivery of defective goods, because of a failure to obtain administrative approval for the contract, or because of the failure to obtain the issuance of a letter of credit), the other party has an option either of maintaining in effect the countertrade commitment or the counter-export contract or of being released from its obligations thereunder.

54. Paragraphs 48 to 54, above, addressed the question whether a termination of a supply contract in one direction is to affect the obligations of the parties to conclude or perform a supply contract in the other direction. The parties may also wish to consider whether the termination of a supply contract in a given direction should obligate the parties to conclude a substitute supply contract in that same direction. An obligation to conclude a substitute supply contract may be considered appropriate in particular when the countertrade agreement provides for the conclusion of multiple supply contracts or when the countertrade agreement lists different types of countertrade goods.

3. Failure to pay

55. In many countertrade transactions it is agreed that payment under the supply contract in one direction is to be made independently from payment under the supply contract in the other direction. For example, if under a counter-purchase or buy-back transaction the importer would delay its payments to the exporter, the exporter (counter-importer) would not be entitled to withhold payment under the counter-import contract or to set off its claim under the export contract against its payment obligation under the counter-import contract. Similarly, if the counter-importer would delay payment to the counter-exporter, the counter-exporter (importer) would not be entitled to withhold payment under the export contract or to set off the payment claims in the two directions. It is advisable that such agreement on independence of payment obligations be expressed in the countertrade agreement.

56. It may be agreed, however, that, if a supplier has not been paid for goods delivered in one direction, that supplier is entitled to withhold payment for goods delivered in the other direction up to the amount of the outstanding claim or to set off the two countervailing claims.

57. The advantage of independence of payment obligations is that the risk of non-payment under a supply contract in one direction is not increased by making the payment obligation under that contract dependent on the successful performance of a supply contract in the other direction. With such an approach, financing for a supply contract may be easier to obtain because the financing institution, in assessing the risk of non-payment, would not have to take into account circumstances extraneous to the supply contract to be financed (see also paragraph 43, above).

58. The advantage of making the payment obligations interdependent is that of additional security to a party who does not receive payment for the goods it has supplied. If that party withholds payment or sets off the claims for payment under the supply contracts in the two directions, the result would be similar to a linked payment mechanism discussed in chapter IX, "Payment" (i.e., retention of funds, blocking of funds or setoff of countervailing

claims for payment). The difference is that in the case discussed in this section the withholding of payment or setoff of claims is a fall-back right given to a party who does not receive payment, whereas under the linked payment mechanisms discussed in chapter IX, the linkage of payments is the anticipated method of payment.

59. When it is agreed that a party is entitled to withhold payment or to set off the two countervailing payment obligations, it is sometimes also stipulated that the party who delivered goods first (exporter) is entitled to take possession of the goods that are to be delivered by the other party (importer). Taking possession of the goods would enable the exporter, who is holding the outstanding claim, to obtain value and establish a payment obligation that could be set off against the outstanding claim. Such a stipulation is possible where the countertrade agreement specifies the goods that are to be counter-exported. In order to implement such an approach, it is advisable to identify clearly the goods and their location and to consider taking such additional measures as granting the exporter a security interest in those goods and giving the exporter an express right to claim their possession. A further measure may be for the countertrade parties to agree that the counter-exporter is to deposit the goods with a third person and to provide for the release of those goods to the counter-importer under specified conditions.

4. Failure to deliver goods

60. The parties may wish to clarify in the countertrade agreement the consequences for the countertrade transaction of a failure to deliver, delayed delivery, or delivery of non-conforming goods under a supply contract in one direction. For delivery problems that result in the termination of a supply contract in one direction, the parties may wish to clarify in the countertrade agreement, as discussed in paragraphs 48 to 54, above, whether the termination is to affect the obligations of the parties with respect to the conclusion or performance of supply contracts in the other direction. For delivery problems under a supply contract in one direction that do not result in termination of that supply contract, the parties may wish, for reasons explained in paragraphs 39 to 41, above, to provide expressly in the countertrade agreement that there should be no effect on the obligations of the parties with respect to the conclusion or performance of supply contracts in the other direction. Such an independence of the obligations with respect to the shipments in the two directions may not be appropriate in buy-back transactions in which the counter-export of goods is contingent upon the proper implementation of the export contract.

Note

1/ Official Records of the United Nations Conference on Contracts for the International Sale of Goods (document A/CONF.97/18, annex 1); United Nations, Treaty Series, vol. __, No. __, p. ___; Yearbook of the United Nations Commission on International Trade Law, vol. XI:1980, part three, B.